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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

The Stock Market Crash Hasn't Knocked Out Inflation

There has been a great deal of speculation as to whether or not the stock market crash would dampen inflation concerns. A quick look at the changes in consumer and producer prices in November seems to suggest that inflation is slowing, but a deeper look at the components of the various price indexes and some of the underlying forces at work provides a different picture.

The Consumer Price Index (CPI) rose 0.3 percent in November, month over month. Although this was somewhat smaller than October's gain, over the past 12 months, the CPI has jumped 4.4 percent—the fastest 12-month increase in almost three years and four times the 12-month gain registered in December 1986.

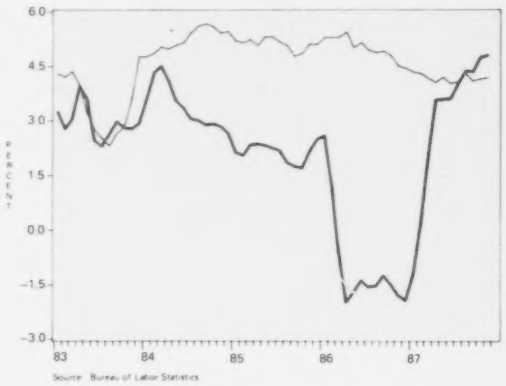
The Producer Price Index (PPI) for finished goods, which mainly covers items made by U.S. manufacturers, and is one stop short of the retail level, remained unchanged in November, month over month. At the moment, the index stands only 2.6 percent above year-ago levels, compared with a 3.4 percent year-over-year rise back in July. While this is encouraging, there are signs of inflationary pressures in the industrial materials sector where factories are working at nearly full capacity—especially in nondurable materials factories where over 88 percent of capacity is being used.

The recent runup in prices of industrial goods can be seen in the PPI for intermediate materials excluding food and energy. This intermediate index, which measures the change in the prices of items before they reach the finished-goods stage, rose a hefty 0.5 percent in November, month over month; in the first two months of the fourth quarter it is up at an annual rate of 9.6 percent compared with 5.0 percent, 3.5 percent and 2.7 percent increases in the third, second and first quarters of 1987, respectively. Historically, price increases for intermediate goods have worked through to finished-product prices within six to 12 months, indicating that larger increases may be in store for finished goods.

Higher Imported Goods Prices

The falling dollar, which is down about 50 percent from its February 1985 peaks against the Japanese yen and German mark, is also contributing to inflationary pressures by pushing up prices of imported goods. Over the past year, prices of imported items have risen by about 8½ percent, compared with a *drop* of about seven percent in the three quarters before that. These higher

12-MONTH PERCENT CHANGE IN CONSUMER PRICE INDEX: GOODS (THICK) VS. SERVICES (THIN)



Source: Bureau of Labor Statistics

import costs have enabled many U.S. producers to boost prices. In the auto industry, for example, exchange rate adjustments have pushed foreign auto makers to raise tabs 25 percent over the past two years. And, the Big Three domestic car makers took advantage of this and have charged an estimated 10 percent more on 1988 models.

One interesting effect of higher-priced imports has been a switch in the inflation trends of the two broad categories of consumer purchases covered by the CPI—goods (foods, clothing, appliances, cars, etc.) and services (medical care, transportation, housing and energy services). Although consumer spending between these two groups is divided almost evenly, the inflation trends in these categories have been strikingly different.

Since late 1983, the 12-month change in services prices had been running much higher than that for goods prices (see chart). In fact, at the beginning of 1987, services

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inflation outran goods inflation by 5½ percentage points. Now, goods inflation is higher than services inflation, and this is with the rate of services inflation on a new upward trend. Besides the rise in oil prices, the main reason for this change is the removal of the constraint lower-priced imports had placed on domestic goods prices. What is more, the change occurred quickly: In January of last year, the 12-month change in goods prices was a *decline* of 1.2 percent, by May 1987 it was a plus 3½ percent—and during the 12 months ending in November, prices of goods jumped nearly five percent.

Larger Wage Increases

One positive factor in the inflation outlook is a slowdown in the rate of rise in unit labor costs. Since labor costs account for about two-thirds of all business expenses, rising labor costs generally translate quickly into higher wholesale and retail prices. Unit labor costs rose only 0.2 percent at an annual rate in the third quarter of 1987, after posting an average gain of about 2½ percent in the previous five quarters. However, unit labor costs have not been held down by a slowing in the rate of rise of wages. The small increase in unit labor costs was the combination of a hefty 3.4

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/16/87)	172,070	– 194	+ 19,155
New York City (12/16/87)	37,476	– 285	+ 3,383
Commercial Paper (12/16/87)	358,286	+ 2,342	+ 32,724

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/16/87)	277,461	+ 1,633	+ 5,993
New York City (12/16/87)	58,214	+ 1,110	– 4,109

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/16/87)	806,224	+ 3,446	+33,061
New York City (12/16/87)	171,566	+ 308	+ 1,932

Financial Markets

	Wednesday 12/30/87	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.87%	– .02	+ .07
180-Day Bills†	6.46	– .25	+ .62
Longest Bills†	7.07	– .08	+ 1.15
Recent Issues:			
7⅞S 12/31/89 (When Issued)	7.70	– .11	
8¼S 12/31/91 (When Issued)	8.19	– .11	
8⅞S 11/15/97	8.75	– .08	
8⅞S 8/15/17	8.88	– .04	
Municipals:			
Bond Buyer–20 Bond Index* (12/30/87)	7.86%	– .09	+ .94
Blue List Total ($ Million)	$1,143	– $ 63	–$1,455
30-Day Visible Supply ($ Million)	$ 766	+ $189	–$ 288
Total	$1,909	+ $126	–$1,743
Corporates:			
Moody's Aa Composite (12/29/87)	10.26%	– .01	+ 1.26
30-Day Visible Supply ($ Million)	$6,108	– $115	+$2,875
Stocks:			
Dow-Jones Averages:			
Industrials	1,950.10	– 49.57	+ 50.07
Transportation	754.43	– 15.86	– 50.92
Utilities	174.25	– 1.54	– 31.42
65 Stocks	717.61	– 15.66	– 19.47
N.Y.S.E. Composite Index	138.52	– 2.33	– .13
N.Y.S.E. Avg. Daily Vol. for Week (000's)	130,820	– 35,908	+ 17,830

*34% Taxable equivalent 11.91%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Wednesday 12/30/87	Week Ago
Overnight	6.69%	6.25%
1 month	7.06	7.94
3 month	7.31	7.81
6 month	7.38	7.81
1 year	7.75	8.00
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 yrs.)	9.18%	9.18%
Long Term (10 yrs.)	10.12	10.12

FOREIGN EXCHANGE SPOT RATES

New York Opening (12/30/87)	Currency Per U.S. $	Week Ago
Canada	1.3052	1.3070
France	5.4100	5.5225
Germany	1.5967	1.6380
Italy	1179.00	1206.75
Japan	123.50	126.95
Mexico	2204.00	2204.00
Switzerland	1.2930	1.3325
U.K.*	1.8575	1.8210

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (12/30/87) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	–0.7%	–3.8%

percent jump in productivity offsetting a sizeable 3.7 percent increase in compensation per hour, which was almost four times the increase in wages in the first quarter of 1987. If productivity gains stall, wage increases of this size will translate into a sharp jump in unit labor costs.

Another seemingly positive factor had been the downward trend in raw industrial commodities prices, as tracked by the Commodity Research Bureau (CRB) in the wake of the stock market crash. But, since early December, this trend has reversed. Also, prices of these items are still running well above their 1986 low point and are, in fact, still about 18 percent higher than a year ago.

The recent drop in oil prices is another reason for reduced inflation expectations. Although, lower oil prices will help push down the overall inflation rate and thereby benefit consumers, energy accounts for only about seven percent of a typical consumer's budget. And, when talking about inflation psychology, falling energy prices probably won't ease consumers' concerns all that much when they find themselves paying over six percent more for medical care and apparel than they were in November 1986. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 12/23/87	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	226.735	+ .171	+18.031
Loans to Depository Inst.	.586	– .289	+ .032
Float	1.188	– .754	– .225
Total Reserve Bank Credit	244.707	– .343	+17.642
Treasury Deposits with Federal Reserve Banks	4.219	– .598	+ .828
Currency in Circulation	227.672	+ 1.225	+17.911
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	197.382	– 1.126	+34.209
	12/16/87		
Member Bank Reserves:			
Total Reserves Held	58.933	+ 1.014	+ 3.008
Excess (Deficiency)	1.203	– .023	+ .463
Net Free Reserves	1.041	+ .033	+ .505
Monetary Aggregates †		**% Change Since 3 Months Ago***	**Year Ago**
M1 (12/14/87)	750.9	+ 2.0‡	+ 5.1‡
M2 (November '87)	2,892.2	+ 4.1	+ 4.2
M3 (November '87)	3,657.8	+ 6.0	+ 5.6
Domestic Nonfinancial Debt (3rd Q'87)	8,139.1	+ 7.6	+ 10.0

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 12/30/87	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	5.81%	6.27%	6.66%
* Federal Agencies	7.20	7.10	7.00
* Municipal Notes—High Grade (34% Taxable Equivalent)	7.20	7.20	7.58
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.20	7.25	7.40

‡Finance Company Paper—Prime

5- 14 days	7.00%
15- 29 days	6.75
30- 59 days	6.75
60- 89 days	6.75
90-179 days	6.75
180-239 days	6.75
240-270 days	6.75

‡* Bankers' Acceptances

Jan.	7.10%
Feb.	7.10
Mar.	7.05
Apr.	7.05
May	7.05
Jun.	7.05

‡Industrial Paper—Prime

30- 89 days	7.30%
90-120 days	7.23

†Federal Funds Effective Rate 6.50%

‡Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'87	$ 4,524	$ 4,445	$ 4,266
Gross National Product (1982 Dollars)*	3rd Q'87	$ 3,836	$ 3,795	$ 3,718
Percent Change, Annual Rate	3rd Q'87	4.3	2.5	1.4
Change in Consumer Prices*	Nov '87	3.6%	4.8%	2.4%
Change in Producer Prices*	Nov '87	0.0%	– 2.4%	0.0%
Civilian Employment (Thousands of Persons) †	Nov '87	113,500	113,187	110,432
Unemployment as % of Civilian Labor Force †	Nov '87	5.9%	6.0%	6.9%
Personal Income*	Nov '87	$ 3,834	$ 3,851	$ 3,590
Leading Indicators Composite Index (1967=100)†	Nov '87n	190.2	193.5r	182.7
Industrial Production Index (1977=100) †	Nov '87	132.5	132.0	125.7
Net Change in Consumer Installment Credit †	Oct '87	$ 3.74	$ 6.42	$ 5.59
U.S. Merchandise Trade Balance	Oct '87	–$ 17.63	–$ 14.08	–$ 12.06
Plant and Equipment Expenditures*	1st Q'88	$427.97(a)	$417.25(a)	$372.24
Private Housing Starts (Thousands of Units)*	Nov '87	1,637	1,523	1,637
New Construction Expenditures*	Oct '87	$ 407.9	$ 409.8	$ 394.9
Total Business Inventories †	Oct '87	$ 687.9	$ 682.3	$ 655.6
Total Business Sales †	Oct '87	$ 462.2	$ 462.4	$ 429.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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